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TORREJON FOR AMBASSDOR CARLUCCI AT VIP GUEST QUARTERS

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TAGS: EFIN, PO

SUBJECT: DRAFT TESTIMONY FOR SENATE ON CONSORTIUM LOAN

REF: CARLUCCI-ROWELL TELECON 2-18-77

1. FOR YOUR INFORMATION AND COMMENTS, THERE FOLLOWS THE
TEXT OF UNCLEARED EUR/WE DRAFT TESTIMONY FOR USE BY THE
PRINCIPAL WITNESS AT 2-25 HEARING ON US PARTICIPATION
IN LOAN CONSORTIUM FOR PORTUGAL.

2. MR. CHAIRMAN, I AM PLEASED TO HAVE THIS OPPORTUNITY
TO MEET WITH YOU AND MEMBERS OF THE SUBCOMMITTEE TO
DISCUSS OUR PROPOSAL TO PARTICIPATE IN A CONSORTIUM TO
PROVIDE BALANCE OF PAYMENTS ASSISTANCE TO PORTUGAL.

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3. AFTER 50 YEARS OF DICTATORSHIP AND TWO YEARS OF POLIT-
ICAL AND ECONOMIC TURMOIL, A DULY ELECTED GOVERNMENT IN
PORTUGAL IS UNDERTAKING THE DIFFICULT PROCESS OF
BUILDING A STATE BASED ON THE CONSENSUS OF ITS PEOPLE, AND
ON ECONOMIC AND MILITARY COOPERATION WITH THE WESTERN
DEMOCRACIES.

4. THE REVOLUTION OF APRIL '74 DESTROYED PORTUGAL'S TRADITIONAL POLITICAL STRUCTURES BUT DID NOT PROVIDE A NEW

COHESIVE LEADERSHIP OR COHERENT SET OF POLITICAL OR ECONOMIC POLICIES. THE WELL-ORGANIZED COMMUNIST PARTY APPEALING TO THE POPULATION'S SUDDENLY SURGING EXPECTATIONS, ALMOST SUCCEEDED IN GAINING CONTROL OF THE NATION.

5. THE DEMOCRATICALLY ELECTED GOVERNMENT OF PRIME MINISTER SOARES HAS NOW BEEN IN POWER SINCE AUGUST OF 1976. IT IS ASSURING THE PROTECTION OF BASIC HUMAN RIGHTS AND IS REDUCING COMMUNIST AND EXTREME RIGHTIST CAPABILITIES TO SUBVERT THE CONSTITUTIONAL PROCESS. THE GOVERNMENT, HOWEVER, IS FACING SERIOUS ECONOMIC THREATS DUE TO THE BURDENS OF TWO YEARS OF REVOLUTIONARY CHANGE. PORTUGAL IS SUFFERING FROM AN UNEMPLOYMENT RATE OF APPROXIMATELY 15, A TRUE INFLATION RATE OF ABOUT 20-25 PERCENT AND A SERIOUS BALANCE OF PAYMENTS DEFICIT. PORTUGAL HAS HAD TO ADAPT TO THE SUDDEN LOSS OF ITS AFRICAN COLONIES AND THE CONSEQUENT NEED TO ABSORB ABOUT 1/2 MILLION REFUGEES. IT IS HAVING TO REORGANIZE AND RESTORE ITS ECONOMY AT HOME, REORIENTING IT TOWARD EUROPE AND THE US AT A TIME WHEN THE INDUSTRIALIZED DEMOCRACIES ARE THEMSELVES STRUGGLING TO RECOVER FROM THE WORST RECESSION IN DECADES.

6. WHETHER PORTUGAL WILL FINALLY SUCCEED IN ITS STRUGGLE TO OVERCOME LEFT AND RIGHT EXTREMES WILL DEPEND ON SEVERAL FACTORS, AMONG THEM: A CONTINUED PROFESSIONAL, NON-POLITICAL, NATO-ORIENTED ARMED FORCES; THE ABILITY OF LIMITED OFFICIAL USE

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DEMOCRATIC FORCES TO WORK TOGETHER AND TO COMPETE WITH COMMUNISTS IN THE LABOR UNIONS; AND ECONOMIC RECOVERY.

7. SOARES HIMSELF TOLD HIS SOCIALIST PARTY CONGRESS LAST FALL THAT WITHOUT ECONOMIC STABILIZATION THERE CAN BE NO DEMOCRACY. HIS GOVERNMENT HAS SINCE COURAGEOUSLY ADOPTED POLITICALLY DIFFICULT BUT NECESSARY AUSTERITY MEASURES, INCLUDING: LAWS TO RESTORE PRIVATE SECTOR CONFIDENCE; IMPORT TAX SURCHARGES AND PRIOR DEPOSIT ARRANGEMENTS ON IMPORTS TO SAVE FOREIGN EXCHANGE; INCREASED PRICES TO CUT GOVERNMENT DEFICITS; AND PROPOSED RESTRAINTS ON WAGES TO HOLD INCREASES BELOW THE RATE OF INFLATION. DURING DECEMBER 19-26 THE NATIONAL ASSEMBLY APPROVED AN ECONOMIC STABILIZATION PLAN FOR 1977 AND A BUDGET DEFICIT 20 PERCENT LESS THAN IN 1976 IN REAL TERMS.

8. HOWEVER, PORTUGAL HAS AN ACUTE FOREIGN EXCHANGE CASH SHORTAGE AND WILL LIKELY CONTINUE TO SUFFER FOR ANOTHER TWO OR THREE YEARS FROM BALANCE OF PAYMENTS DEFICITS THAT

CANNOT BE COVERED BY NORMAL PRIVATE OR INTERNATIONAL CREDITS ALONE. WE ESTIMATE PORTUGAL WILL HAVE A 1977 FOREIGN EXCHANGE DEFICIT OF AT LEAST 900 MILLION DOLLARS.

9. THE PORTUGUESE NEED ASSURANCE OF SUBSTANTIAL FINANCIAL ASSISTANCE WITH REPAYMENT SPREAD OVER SEVERAL YEARS. SUCH CREDITS WOULD GIVE THEM THE CONFIDENCE AND TIME NECESSARY TO CARRY THROUGH THE ECONOMIC STABILIZATION AND RESTRUCTURING OF THEIR ECONOMY IN ORDER TO SUPPORT GROWTH ON A BASIS COMPATIBLE WITH THE OPEN TRADING AND PAYMENTS SYSTEM OF EUROPE AND THE INDUSTRIAL COUNTRIES GENERALLY. IN A POLITICAL SENSE, SUCCESSFUL COOPERATION OF THE INDUSTRIAL DEMOCRACIES IN SUPPORT OF DEMOCRATIC DEVELOPMENT IN PORTUGAL WILL STRENGTHEN PERCEPTIONS WORLDWIDE OF THE VITALITY OF OUR SYSTEM.

10. IF SUBSTANTIAL FOREIGN LOANS DO NOT MATERIALIZE, THE LIMITED OFFICIAL USE

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PORTUGUESE GOVERNMENT WILL BE FACED WITH THE EXTREMELY DIFFICULT TASK OF TRYING TO IMPOSE SUDDENLY AN EVEN MORE SEVERE AUSTERITY PROGRAM, RISKING PUBLIC PROTEST, GROWING INFLUENCE AND AGITATION BY THE EXTREME LEFT, AND POSSIBLE LOSS OF PUBLIC SUPPORT FOR DEMOCRATIC INSTITUTIONS.

11. WE ENVISAGE A THREE-STAGE BALANCE OF PAYMENTS ASSISTANCE PROGRAM TO HELP PORTUGAL STABILIZE AND DEVELOP ITS ECONOMY. THE FIRST STAGE IS A 300 MILLION DOLLAR LINE OF CREDIT RECENTLY NEGOTIATED WITH THE US TREASURY FROM ITS EXCHANGE STABILIZATION FUND. THE SECOND, THE CENTER-PIECE, IS A SET OF MEDIUM TERM LOANS TOTALLING UP TO 1.5 BILLION DOLLARS FROM A CONSORTIUM OF COUNTRIES. THE THIRD IS FULL USE OF PORTUGAL'S IMF CREDIT RESOURCES.

12. AT PORTUGAL'S REQUEST WE HAVE AGREED TO TAKE THE LEAD IN ESTABLISHING THE MEDIUM-TERM CONSORTIUM PACKAGE. WE WOULD EXPECT TO DISBURSE THE LOANS OVER A THREE YEAR PERIOD HALF OF THEM IN THE FIRST YEAR OF OPERATION. INTEREST WOULD BE NON-CONCESSIONAL, I.E. AT THE COST OF MONEY TO THE LENDING TREASURIES. THIS WOULD NOT BE THE KIND OF SUBSIDIZED OR PROJECT ASSISTANCE USUALLY ASSOCIATED WITH AID OR THE INTERNATIONAL DEVELOPMENT BANKS. THE US SHARE OF THE TOTAL WOULD BE NO MORE THAN 40 PERCENT UP TO A MAXIMUM OF 550 MILLION DOLLARS.

13. WE ARE HERE BEFORE THIS COMMITTEE TO REQUEST CONGRESSIONAL SUPPORT FOR THIS PROPOSAL. IT IS NECESSARY TO HAVE THIS EARLY US COMMITMENT BOTH TO MAKE SURE THAT SOME FUNDS ARE AVAILABLE TO MEET PORTUGAL'S MOST CRITICAL BALANCE OF

PAYMENTS NEEDS AS SOON AS THE CONSORTIUM HAS BEEN FORMED;
AND TO INDUCE OTHER COUNTRIES TO JOIN THE CONSORTIUM. THE
UNITED STATES HAS PROVIDED SUBSTANTIAL PL-480 AND CCC

COMMODITY LOANS AND RELATIVELY SLOW-DISBURSING AID
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PROJECT ASSISTANCE OVER THE PAST TWO YEARS; BUT THE EURO-
PEANS -- ESPECIALLY THE FEDERAL REPUBLIC OF GERMANY --
HAVE PROVIDED MASSIVE BALANCE OF PAYMENTS HELP, ABOUT 1
BILLION DOLLARS, AND THEY ARE RELUCTANT TO DO MORE NOW
UNLESS WE CAN SHOW WE WILL CONTRIBUTE ALSO.

14. THE EXACT SIZE, TERMS AND CONDITIONS OF THE CONSOR-
TIUM PROGRAM WILL BE DETERMINED ON THE BASIS OF MUTUAL
AGREEMENT BETWEEN PORTUGAL, THE US, AND THE OTHER PARTI-
CIPANTS, WE ARE ALREADY INITIATING SOUNDINGS WITH OTHER
POTENTIAL PARTICIPANTS. THERE IS A STRONG DISPOSITION,
ESPECIALLY IN EUROPE, TO HELP PORTUGAL AND ASSURE ITS SAFE
DEMOCRATIC TRANSITION. AT THE SAME TIME, BECAUSE OF
DIFFERING FISCAL YEARS AND FINANCIAL MECHANISMS, IT IS
POSSIBLE THAT IN THE FIRST YEAR OF OPERATION THE UNITED
STATES WOULD HAVE TO MAKE ITS CONTRIBUTION AVAILABLE AT
THE BEGINNING OF THE YEAR, LEAVING SUCCEEDING TRANCHES IN
THE YEAR TO THE OTHER CONTRIBUTORS. BY THE END OF THE
FIRST YEAR, THOUGH, WE WOULD EXPECT ALL MEMBERS TO BE
CONTRIBUTING THEIR AGREED SHARES. IN THIS REGARD WE EN-
VISAGE A CONTRIBUTION FROM THE EUROPEAN COMMUNITY
APPROACHING OUR OWN, ABOUT 40 , WITH THE REMAINDER COMING
FROM OTHER OECD COUNTRIES AND PERHAPS ONE OR TWO OPEC
COUNTRIES.

15. MR. CHAIRMAN, TWO SUMMERS AGO MARIO SOARES AND OTHER
CIVILIAN LEADERS OF DEMOCRATIC PARTIES PLUS A BRAVE GROUP
OF DEMOCRATIC MILITARY OFFICERS TOOK TO THE STREETS IN
LISBON -- RISKING BOTH THEIR IMMEDIATE PERSONAL SAFETY
AND THEIR CAREERS -- TO CHALLENGE A COMMUNIST AND EXTREME
LEFT THREAT WHICH HAD SEIZED THE MASS MEDIA, INFILTRATED
AND NEUTRALIZED THE ARMED FORCES AND POLICE, COMMANDEERED
THE BUREAUCRACY, AND WAS RAPIDLY PERVERTING PORTUGAL'S
REVOLUTION TO ITS OWN ENDS. WE ASSURED THOSE DEMOCRATIC
LEADERS OF OUR SUPPORT AND THEY TENACIOUSLY FOUGHT ON.

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16. THEY HAVE NOW EMERGED ON TOP AND INSTALLED A NEW

DEMOCRATIC GOVERNMENT.

17. WITH TREMENDOUS POLITICAL COURAGE THEY ARE IMPOSING ON THEIR PEOPLE THE SACRIFICES NECESSARY TO OVERCOME THE ECONOMIC DISORGANIZATION RESULTING FROM TWO YEARS OF POLITICAL STRUGGLE. BUT THEY MUST HAVE HELP NOW IF THEY ARE TO WARD OFF RESURGENT THREATS FROM LEFT AND RIGHT EXTREMISTS, AND SUCCEED IN STABILIZING THE ECONOMY AND CONSOLIDATING THE COUNTRY'S FLEDGLING DEMOCRATIC INSTITUTIONS. APPROPRIATION OF THE FUNDS WE ARE REQUESTING

TODAY WILL PROVIDE HELP WHEN IT IS NEEDED. IT WILL STIMULATE OTHER MEMBERS OF THE WESTERN DEMOCRATIC COMMUNITY TO DO THEIR SHARE AS WELL, AND WE WILL SHOW THE WORLD THE BENEFITS OF MEMBERSHIP IN THE FAMILY OF WESTERN DEMOCRACIES.

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